

COST-SHARING AND PROJECT FINANCING

Lillian Almodovar¹ and John W. Meyer²

AUTHOR: ¹Regional Economist, Economics and Social Analysis Division, Planning Directorate, U.S. Army Corps of Engineers, South Atlantic Division; ²Civil Engineer, Plan Formulation and Program Management Division, Planning Directorate, South Atlantic Division, U.S. Army Corps of Engineers, 77 Forsyth St. SW, Atlanta, Georgia 30335-6801.

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INTRODUCTION

The Water Resources Development Act of 1986 (WRDA 86), Public Law 99-662, established new rules for the cost sharing of Federally authorized water resources projects. For the first time, sponsors are required to share in the cost of feasibility studies to ensure that dwindling Federal dollars are spent wisely with priority to those projects with strong sponsor support. Sponsors are also required to pay a share of the Planning, Engineering, and Design (PED) and project construction costs in addition to the traditional costs for lands, easements and rights-of-way.

With the passage of WRDA 86, the roles and responsibilities of both the Corps of Engineers (CoE) and the non-Federal sponsors changed radically. The CoE (no longer a sole benefactor) and the non-Federal sponsor (no longer a passive recipient) became partners in the development of water resources projects.

This partnership brings along increased financial responsibilities to the non-Federal sponsor and increased management responsibilities to the CoE. The Project Cooperation Agreement (PCA), formerly LCA, details the responsibilities of all parties involved in project development. An important element of the PCA is a financial analysis package to ascertain the non-Federal sponsor's ability to meet financial requirements necessary for project implementation. New cost-sharing requirements under WRDA 86 and the elements of the financial analysis package are the two main topics of this paper.

COST-SHARING PROVISIONS

Feasibility Studies. Section 105 of WRDA 86 established cost sharing requirements for feasibility studies. It stated that the Secretary of the Army could not initiate a feasibility study for a water resources project until appropriate non-Federal interests agreed by contract (the Federal Cost Sharing Agreement, FCSA) to contribute 50 percent of the cost of such study. It further provided that not more than one-half of such non-Federal contribution

may be made by the provision of services, materials, supplies, or other in-kind services necessary to prepare the feasibility report. Feasibility cost sharing also applies to Continuing Authorities Program studies (small projects) unless the feasibility phase cost is \$40,000 or less. However, feasibility cost sharing does not apply to projects designed primarily for the purpose of improvements to the inland waterways system.

Planning, Engineering And Design. WRDA 86 originally provided that cost sharing for Planning, Engineering and Design (PED) would be 50-50 with a signed contract with a non-Federal sponsor. Design costs would be shared in the same proportion as the cost sharing for the purpose of the water resource project being constructed. These provisions were amended by Section 301 of the Water Resources Development Act of 1990 (Public Law 101-640) which provided that all planning and engineering costs for projects which the feasibility study had been cost shared 50-50 would now be cost shared in the same proportion as project construction. Now all PED costs are cost shared the same as construction. The procedure is for the government to fund all PED costs prior to approval of the first set of plans and specifications. Prior to advertising the construction contract, there must be an executed Project Cooperation Agreement (PCA) between the government and the non-Federal sponsor. One provision of this PCA will call for the sponsor to pay his share of the PED costs during the first year of construction. There are no provisions for credit to the sponsor for in-kind services during PED.

Construction. The cost sharing by project purpose as established by Title I of WRDA 86 is summarized in Table 1.

FINANCIAL ANALYSIS

The financial analysis package, submitted prior to initiation of construction, should be the final product of a process that encompasses all phases of project development (Reconnaissance, Feasibility, and PED). An early

determination of the non Federal sponsor financial capabilities eliminates or, at least, minimizes delays in project execution due to lack of adequate funding. Delays in project execution result in higher costs that could hinder the implementation of the projects or result in partially completed projects that do not achieve the purposes for which they were designed. Even though not a single project has been affected by a default in adequate funding since the passage of WRDA 86, the cost of avoiding this possibility via the financial analysis is worthwhile. The need to avoid this risk explains the current emphasis on conducting a sound financial analysis during all phases of project development.

Requirements

The scope and requirements of the financial analysis vary depending on various factors: the type of study (or project), the phase of development of the study, and the financing mechanisms to be used for project implementation.

Type of Study. The type of study refers to the authority under which the project is developed. Projects specifically authorized by Congress usually require a substantial investment of funds. Projects conducted under the Continuing Authority Program (CAP), are small projects that require a smaller investment. Obviously, the larger the investment required, the more comprehensive should be the financial analysis. Exceptions to this rule are small projects sponsored by entities that have limited financial capabilities (some counties and towns). In this case, the financial analysis is a critical element in project execution.

Study Phase. The three major phases of project development are: reconnaissance, feasibility and design. The purpose of the financial analysis during the reconnaissance phase is to assess the non-Federal sponsor's level of interest and support for the project. A letter from the sponsor should be included with the Reconnaissance Report stating that the sponsor fully understands the cost sharing requirements, the basis of the authority to be a sponsor of the project and the preliminary financial options available.

During the feasibility phase it is important to determine the financial implementability of the proposed project and to assure the support from the sponsor before the project is submitted for authorization by Congress (or is approved under the CAP). A preliminary financial analysis needs to be provided with the Feasibility Report in order to make these determinations. The components of the preliminary financial analysis are the same as those for the final analysis and will be discussed in the following section.

It is at the end of the design phase, and before the signature of the PCA, when the financial analysis becomes a critical element in the decision making process. The purpose of the analysis at this phase is to ensure that the

sponsor has a firm and reasonable plan to fulfill his/her financial responsibilities.

Financing Mechanisms. Non-Federal sponsors for Corps projects are classified in two broad categories: general purpose governments and special purpose governments. General purpose governments are States (and their Departments), Counties, Municipalities and Townships. Examples of special purpose governments are Port Authorities, Transportation Authorities, Water Pollution Control Districts, Irrigation and Flood Control Districts and Special Assessment Districts.

Financing mechanisms available vary for each type of government. Sponsors have several options to obtain the up-front capital required for the construction of the project as well as the annual operation and maintenance funds. Among these options are: cash available (appropriations, grants, donations, operating revenues); private parties and privatization arrangements (commercial loans, corporate bonds, private activity bonds); short-term debt (Municipal notes, usually repaid within one year); and, long-term debt (revolving funds, bonds). The scope of the financial analysis is minimized when the non-Federal sponsor demonstrates that they have the cash-on-hand for their share of the project (first financing option). State Legislature appropriations, when approved, are considered as cash available (even when they only cover one year at a time). The use of other financing mechanisms (private sources, short and long term debt) requires a comprehensive analysis of the credit history and capabilities of the sponsor and the time reschedule required to secure the funds as compared to the construction schedule of the project.

Components

The financial analysis package consists of three major elements: a financing plan, a statement of financial capability and the District assessment. The first two elements are prepared by the non-Federal sponsor while the third one is prepared by the CoE.

Financing Plan. The financing plan should include a schedule of expenditures that identifies the contributions required from each partner during the construction period, on a yearly basis. The cash contribution required from the sponsor can be paid up front, at the beginning of construction, or distributed throughout the construction period in accordance with the construction schedule. This last option is the one preferred by most non-Federal sponsors. The first year's contribution from the non-Federal sponsor includes its share of the monies expended during the design phase, since this phase is totally funded with Federal funds. The schedule should also take into account all credits applicable to the non-Federal share. A brief description of some of these credits will be provided in a subsequent section.

Another important element of the financing plan is the schedule of sources and uses of funds. All outlays and sources of funds, by year, need to be identified in this schedule. Outlays during construction include cash payments to an escrow account or the government; payments for lands, easements, rights-of-ways, relocations, replacements and disposals (LERR&D); and associated costs. If bonds are issued to finance the project, outlays should also include insurance related costs and interest paid to bond holders during construction. Outlays after construction include bond debt, service, repayments to the government and operation, maintenance, replacement, repair and rehabilitation (OMRR&R) costs. An explanation of the method of financing should also be included in the financing plan.

Statement of Financial Capability. The objective of the statement of financial capability, prepared by the non-Federal sponsor, is to document the sponsor's authority to obtain and utilize the funding sources that were identified in the financing plan. Evidence of the sponsor's credit worthiness is another important element of this section of the financial analysis package. In the case where third parties would be involved in financing the project, a statement of financial capability should be submitted for each party.

District's Assessment. The last component of the financial analysis package is the District's assessment of the financial capability of the non-Federal sponsor. The District has to certify that it is reasonable to expect that all funds required for construction will be available at the time due. This assessment should be based on the information submitted by the non-Federal sponsor and a careful review of other pertinent data, such as previous history of performance, if any, credit records, credit standing, etc.

The financial analysis is reviewed at the Division and Washington levels of the Corps of Engineers and ultimately approved by the Office of the Assistant Secretary of the Army for Civil Works.

Credits

WRDA 86 entitles the non-Federal sponsor to apply for various credits to be applied towards its share of project costs. Specific guidance for the application of these credits should be pursued before the non-Federal sponsor invests funds in the project or any of its features. Section 104 of WRDA 86 provides credit for work performed by the non-Federal sponsor for flood control projects. Section 204 provides credit for works performed in harbors or inland harbors. Section 215, also applicable to flood control projects, provides for credit or reimbursement for work the non-Federal sponsor wishes to perform on a Federally authorized project. PL 84-826 provides

credit for works related to hurricane and storm damage prevention projects. Other credits might be applicable depending on the type of project and should be fully investigated by the sponsors.

CONCLUSIONS

The financial analysis package required by WRDA 86 for all Corps of Engineers projects constitutes a powerful tool for both the non-Federal sponsor and the CoE. The determination of cost sharing responsibilities in the early phases of project development and the identification of specific sources of funds before initiation of construction minimizes the possibilities of delays in project execution. These delays could represent higher costs for both the Federal and non-Federal partners. In the current national and local economic environment, avoidance of delays and associated costs should be a major concern of all those involved in the development of publicly financed projects.

LITERATURE CITED

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Table 1

Non-Federal Share Of Project Costs For Federally Authorized Water Resources Projects

Project Purpose/Type	Project Cost (A)	LERRD's ¹ (B)	OMR&R ² (C)
Flood Control Structural	Five percent of total cost (cash). ³	All costs assigned to purpose.	All costs.
Flood Control Non-structural	Twenty five percent with credit for LERRD's ⁴	All costs.	All costs.
Deep Draft Navigation	Percent of costs of general navigation features varies in accordance with recommended depth. ⁵ For all depths: an additional cash contribution of 10 % of the cost of general navigation features. ⁶	All costs, except railroad bridge relocations	For depths over 45 feet: 50 % of additional O&M costs.
Inland Waterway Navigation	None for waterways where users are subject to fuel taxes paid to Inland Waterway Trust Fund. Improvements for other waterways are cost shared in accordance with terms of specific authorization.		
Shore Protection	Share of construction costs based on shore ownership and public use. ⁷	All costs.	All costs, except cost of periodic nourishment ⁸
Hydroelectric	Cost sharing in accordance with existing law which anticipates full recovery of Federal cost through sale of power.		
Water Supply	All costs, including OMR&R, reimbursed by the sponsor in a period not to exceed 30 years from day of first use.		
Recreation	50 percent of separable total costs.	All costs.	All costs.
Continuing Authorities Projects	Cost shared by project purpose in accordance with rules above. The sponsor also pays all project costs in excess of the Federal limitation established for each Continuing Authority.		

NOTES:

1. Lands, Easements, Rights-of-ways, Relocations and Dredged Material Disposal Areas.
2. Operations, Maintenance, Repairs and Rehabilitation.
3. 25 percent minimum/50 percent maximum rule applies. If (A) + (B) is less than 25 percent of the total cost of the project, sponsor must pay the required additional amount to bring share up to 25 percent. If (A) + (B) is more than 50 percent of the total cost, the sponsor pays only 50 percent.
4. 25 percent minimum rule applies. If the value of LERRD's is less than 25 percent of the total cost of the project, sponsor must pay the required additional amount in cash to bring its share up to 25 percent.
5. 10 percent for channel depths up to 20 feet; 25 percent for channel depths over 20 feet but less than 45 feet; 50 percent for channel depths over 45 feet.
6. The additional 10 percent contribution may be financed over a period not to exceed 30 years. Sponsor's LERRD's costs, except utilities, are credited towards the 10 percent contribution.
7. None for Federally owned lands and shores; 100 percent for privately owned lands (undeveloped) and shores (where use is limited to private interests); 35 percent for privately owned, developed lands where criteria for public use of the shores are met; 50 percent for non-Federal public shores used for parks and recreation. Sponsor's LERRD's costs are credited against the share of construction costs; excess LERRD's costs are reimbursed to the sponsor.
8. Cost of periodic nourishment shared in the same proportion as initial project construction costs.